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SUBJECT: Criticism Persists at Home and Abroad over French
GDF-Suez Merger

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¶1. (SBU) Summary: Criticism of the proposed merger of Gaz de France (GDF) with water and power utility Suez continues both at home and abroad. Domestically, unions and the left protest proposed GDF privatization. Abroad, Brussels, Italy and other EU member states denounce French "economic patriotism" as a threat to European integration and energy sector consolidation. Because this merger announcement came only days after Italian power company Enel publicly revealed its interest in bidding on Suez, Italian protests have been the harshest. The French and Italian governments most recently vowed to let the companies work it out without (further) political interference. We expect the GDF-Suez deal to proceed, but the European Commission undoubtedly will be watching events with interest. End summary.

¶2. (U) On February 27, with company CEOs by his side, Prime Minister Dominique de Villepin announced a planned 70 billion euro merger of Franco-Belgian water and power group Suez with partially-privatized Gaz de France (GDF) to create Europe's largest utility. The combined group would enjoy an unrivalled portfolio in terms of gas supply options, with a 15% European market share in natural gas and strong presence in the expanding sub-sector of liquefied natural gas. In the electricity sector, adding Suez's power plants to GDF's gas customers should provide credible competition for Elecricite de France (EDF).

¶3. (U) Under different circumstances, neutral observers might consider this a sensible business tie-up. GDF alone is viewed as too small, with annual sales of 18 billion euros earned largely within France and virtually no presence in the electricity sector. A merger with Suez would push GDF into the power market and beyond French borders, thus helping it to survive and even possibly thrive in Europe's liberalizing energy markets.

¶4. (SBU) Villepin asserted that his support for the GDF-Suez merger was motivated by this "industrial logic" as well as the "strategic importance of energy for France." However, many attribute the motivation to Enel's interest in acquiring Suez, which the Italian power company made public on February 22. GOF officials have consistently insisted to us that GDF and Suez had been talking for months, whereas the threatened hostile take-over bid from Enel came as a surprise, which only accelerated the GDF-Suez talks. In

response to Italian protests, the European Commission will review the proposed merger once GDF and Suez put forward a detailed proposal, but our French Industry Ministry contacts did not expect this to happen before Italian elections.

¶5. (U) Enel has recently reaffirmed its interest in Suez, emphasizing that they are leaving their options open. Enel lost its French partner Veolia -- a water, waste, and transport group -- whose chairman recently confirmed that they have abandoned a plan to launch a joint bid with Enel for Veolia's rival Suez. Nevertheless, the Italian utility, which is 30% owned by the Italian government, has reportedly lined up a pool of about eight banks to provide it with about 50 billion in financing should it decide to bid for Suez.

Domestic Reaction:
No to privatization, Yes to economic patriotism
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¶6. (U) GOF intervention to bring GDF and Suez together has attracted much criticism. Within France, the criticism has focused on the privatization of GDF. For political reasons, the all-share deal is structured as an offer by the smaller GDF gas group for Suez. In order to swap shares, the GOF must successfully push forward a change in the 2004 French law, which requires the GOF to keep a minimum 70% stake in GDF. The GOF currently holds 80% of GDF. Under the merger deal, the GOF is not expected to go below a 34% blocking minority. However, opposition parties and union leaders, already agitating against labor code reforms, strongly oppose any further privatization. Minister Breton is trying to assuage union opposition by promising that the GOF will ensure that French jobs are preserved as well as GDF workers' envied civil service status and benefits.

¶7. (U) Predictably, the GOF has responded to the inevitable anti-privatization backlash by claiming defense of national interests, protecting French water and power company Suez from falling under Italian control. French reaction to this "economic patriotism" argument has been favorable. According to a recent poll, 69% of people interviewed were in favor of GOF intervention to prevent foreign takeovers of French companies. According to those interviewed, international mergers bring the impression of globalization and job losses in France. The proposal to conserve Suez under French ownership is popular, with 67% of interviewees considering it a "good thing." However, only 32% of those interviewed were in favor of the privatization of GDF.

Reactions from other EU member states

¶8. (SBU) European reaction has been largely negative, with particularly harsh criticism from Italian government officials. Before the GDF-Suez merger announcement, French Finance Minister Breton and PM de Villepin informed their Italian counterparts of their opposition to Enel's "hostile" bid for Suez. President Chirac later contacted Prime Minister Berlusconi and reasserted the bid's hostility adding that there was no French partner who would support Enel's bid. (Comment: We suspect the GOF may have played a role in convincing Veolia to drop the idea of a joint bid for Suez with Enel. End comment.)

¶9. (U) Italy responded that the planned bid was not hostile and the GDF merger was a deliberate act of GOF protectionism. Italian Industry Minister Scajola called the blockage of the Enel takeover, "an enormous violation of EC law." Italian Economy Minister Tremonti warned that French protectionism "must be stopped" or else "we risk an August 1914 effect." On March 13, Minister Breton met with his Italian counterpart to discuss the deal. After the meeting, Breton said they had agreed to let the companies sort out

their differences without political interference.

¶10. (SBU) This is not the first troubled deal in the French/Italian energy sector. For almost four years, Italy resisted EDF's attempts to increase its stake in Edison, Italy's second largest power generator. Finally, last year, the European Commission brokered a deal for EDF to buy a 50% stake in Edison. In exchange, Italy was allowed to buy a 12.5% share in EDF's planned French nuclear facility as well as shares in SNET, France's second-largest power generator. The two countries resisted agreeing to a deal, until Brussels threatened to force governments to sell company shares to open their markets, according to a European Commission official.

¶11. (SBU) The merger of GDF and Suez will also have to address concerns of energy market regulators and competition authorities. Already, the Belgian regulator reportedly recommended that GDF sell its 25% stake in SPE, which is Belgium's only other power producer apart from Suez's Electrabel. Suez also owns portions of Belgium's electricity grid operator Elia, Belgium's gas pipeline network Fluxys, and Distrigas, a gas distributor which holds roughly 80% of the Belgian market. "The French government would have a say in our transportation structure, which in our view in terms of security might cause problems," Belgian Commission of Regulation of Electricity and Gas spokesman said. The Belgian regulator also expressed concerns about security of nuclear energy supplies, recommending that Electrabel sell some of its nuclear assets. In Belgium at least, French economic patriotism may be getting a taste of its own medicine.

GOF response: We're more open than most

¶12. (SBU) In response to accusations of protectionism, French officials have highlighted France's relative openness, citing statistics on foreign direct investment. Chirac's recent comments in Berlin were illustrative of this line. He pointed to the fact that France receives twice as much foreign direct investment as Germany, for example. Chirac claimed that "France is one of the most economically liberal states in Europe." The French, unlike the Germans, have privatized water utilities and highways, and the French

lead Europe in mergers and acquisitions, he further argued. The MFA DAS-equivalent for energy matters, Nicole Taillefer, had earlier made these same points to us, emphasizing that France is more open to investment than other European countries, particularly Germany. She claimed that French investment in Italy is roughly equal to Italian investment in France, noting Enel's stake in planned nuclear reactor in Normandy.

Comment

¶13. (SBU) After the Russia-Ukraine gas dispute and steady increases in oil and gas prices, the GOF seems to be staking out energy as a national security issue and therefore a prominent part of its economic patriotism policy. However, GOF actions may lead to a fragmented (along national borders) energy sector rather than to greater EU-wide energy security. Meanwhile, GOF tactics in defending the GDF-Suez merger have been contradictory, stressing economic patriotism and vowing to protect jobs at home, while defending the general openness of the French economy abroad. Perhaps this is why criticism has persisted. The GOF's own mixed messages are being used against them.

¶14. (SBU) Minister Breton's recent agreement with his Italian counterpart to let the companies work it out without political inference indicates that the GOF is confident that Suez will continue to support its merger with GDF, even if Enel's rumored cash offer materializes. If the two

governments, Suez, GDF, and Enel cannot work it out for themselves, the European Commission may be tempted to weigh in to broker a deal similar to the Endesa/EDF compromise. End comment.

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